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Tiivistelmä-Referat-Abstract

The purpose of this work is to examine the causes of financial crises. The analysis of this work is based on the recent empirical and theoretical studies. These studies have focused on the role of financial factors in the analysis of the crises. A deterioration in macroeconomic and financial indicators seems to be a common and essential sign for both banking and currency crises. A common view is that financial crises originate from weak financial fundaments which make the economy vulnerable to banking and currency crises.

First, this work presents and analyses empirical and theoretical research on financial crises. It highlights the financial factors behind these crises. It also provides a review of the causes of financial crises and examines the circumstances under which the economy is vulnerable to financial crises. The main emphasis is on the international illiquidity of the financial system since it is a common feature of several financial crises and it is also argued to be a sufficient condition for banking and currency crises. International illiquidity is here determined as a mismatch of international liabilities and short-term foreign assets.

Three specific factors explaining financial crises are worth mentioning. First, financial crises are usually associated with poorly designed and supervised financial liberalisation. Second, weak banking system, lending boom and expansive foreign borrowing are often related to these crises. Third, illiquidity of the financial system makes the whole economy more vulnerable to banking and currency crises.

The work provides a theoretical framework for the analysis of international illiquidity. It presents a basic model constructed by Chang and Velasco (1998b) which contributes to the analysis of the factors behind the illiquidity problem. The model also serves as a measure of illiquidity. The main conclusion from the model is that short-term debt and foreign currency debt increases the mismatch of international liabilities and international liquid assets and thus, the possibility of a financial crisis.

This work also studies international illiquidity in a framework of different exchange rate regimes. The major question then is: Can banking and/or currency crises be avoided under these regimes? The main conclusions based on the model of Chang and Velasco (1998a) are that under fixed exchange rate regime authorities have little means to prevent both banking and currency crises, whereas, in the case of flexible exchange rate regime avoiding both crises is possible, if there exists a lender of last resort.

Finally the work serves as an empirical analysis of the financial crisis in Finland. The Finnish crisis is a good example of a classical financial crisis. The factors put forth in the recent research on financial crises fit rather well to the Finnish crisis. It also has several common features with other recent crises, in particular the Asian crises.

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